

Modernising Insolvency Law in Latvia: Successes and Failures

Edvins Draba, 2012 Turton Award winner presents a summary of his award winning paper



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THE INSOLVENCY LAW 2008 WAS SOON PUT TO THE TEST OF AN ECONOMIC CRISIS



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Introduction

As a transition economy, Latvia has experience in applying four different insolvency laws since the restoration of its independence in 1991. The most rapid modernisation of the Latvian insolvency legal framework took place during the last five years, promulgating one completely new Insolvency Law just to abandon it after less than three years and adopt an even more modern law instead.

These laws are as follows: the law “On the Insolvency of Undertakings and Companies”, enacted in 1996 (hereafter – Insolvency Law 1996), the Insolvency Law, enacted in 2008 (hereafter – Insolvency Law 2008) and the Insolvency Law, enacted in 2010 (hereafter – Insolvency Law 2010).

Insolvency Law 2008

The necessity to adopt a new insolvency law was substantiated by the following main reasons:

- Excessive orientation of the Insolvency Law 1996 on the protection of creditors, perceiving insolvency proceedings mainly as a form of a liquidation procedure;
- Rare use of restructuring solutions, provided by the Insolvency Law 1996;
- Frequent use of an insolvency petition as an individual debt recovery tool;
- Excessive complexity, limited suitability for SME insolvencies.

Consequently, the Insolvency Law 2008 can be characterised by the following main features implemented to address shortcomings of the previous regulation:

- New subjects introduced, old subjects excluded;
 - a. Personal bankruptcy introduced for the first time in Latvia, providing for a debt discharge over a seven year (later – five year) period;
- Less sophisticated regulation (simplification of procedures):
 - a. Shorter general term of submission of creditors’ claims – cut down from three months to one;
 - b. Other amendments, the most notable of which: an abolition of a committee of creditors – a creditors’ representative institution alongside the creditors’ meeting and an abolition of the procedure for the approval of creditors’ claims by a creditors’ meeting;
- Extended powers of an insolvency administrator – e.g. to conduct the sale of encumbered assets of the bankruptcy estate, previously performed by a secured creditor;
- Legal protection (restructuring) proceedings, separated from insolvency proceedings and featuring a newly introduced “debtor-in-possession”;
- More pronounced orientation on restructuring;
- Insolvency Register introduced, simplifying communication of insolvency-related information and making it significantly more accessible.

The Insolvency Law 2008 was enacted in times of relative prosperity and a credit boom, but was soon put to the test of an economic crisis. The latter illuminated both strong and weak sides of the new regulation, leading to a conclusion that the

usual shortcomings of insolvency and restructuring in Latvia remained where they were before, namely, far from optimal average length of the proceedings and creditor recovery rate (which even decreased). Analysing the Insolvency Law 2008 and the initial aims set by its authors, one can realise that the legislator was overly cautious and unready for radical reforms when choosing to replace the Insolvency Law 1996.

For instance, personal bankruptcy proceedings had numerous deficiencies. Due to their complexity, vague regulation and high costs these proceedings were available mostly to natural persons who were able to retain a high enough income before and upon the commencement of insolvency proceedings. Reversely, they turned out to be inaccessible for low income consumers with a sole dwelling.

Besides, legal protection proceedings proved to be a not much better restructuring tool for distressed companies than previously available recovery and settlement within insolvency proceedings with only marginal success rate, despite being used more frequently.

Insolvency Law 2010

The Insolvency Law 2010 has come out with even more simplified procedures and broadened powers for the administrator.

The main innovations introduced by it in comparison with the Insolvency Law 2008 can be categorised as follows:

- Increased speed of proceedings with strictly set terms;
- Simplification of procedures:

- a. Optional creditors' meetings;
- b. More accessible personal bankruptcy proceedings;
- c. Electronic communication between an administrator and other parties;
- d. Other amendments;
- Easier, more prompt commencement of proceedings;
- The over-indebtedness test replaced by the cash flow test as an entry criterion. Besides, a duty to pay a deposit has been imposed on the applicant, serving as a source of funding of corporate insolvency proceedings in cases where a debtor has no assets;
- Extended powers of an administrator and decreased competence of a creditors' meeting;
- Amended provisions governing legal protection (restructuring) proceedings.

Summary and conclusions as to the reforms in the restructuring and insolvency field in Latvia

- The reforms in the field of insolvency and restructuring in Latvia during the last five years have been associated mainly with simplification and abolition of inefficient procedures, making insolvency proceedings less complicated.
- The competence of the creditor's meeting has been substantially narrowed and the administrator's competence has been broadened, respectively.
- The introduction of the Insolvency Register and electronic communication has significantly reduced costs and time consumption.
- Efforts to make insolvency petition more expensive and less

attractive as a debt recovery tool have contributed to a decrease in corporate insolvency proceedings and thus delayed commencement or non-commencement of actually insolvent businesses.

- In conjunction with the extended powers, the duties of an insolvency administrator have been widened also, especially in personal bankruptcy, while the remuneration has been disproportionately decreased.
- The debtor-in-possession type of legal protection proceedings have not yet achieved the desired rate of successful restructurings in Latvia.



THE DUTIES OF AN INSOLVENCY ADMINISTRATOR HAVE BEEN WIDENED



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